IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1944.

No.....

HARRY EDISON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

OPINIONS BELOW.

The findings of fact and opinion of The Tax Court (R. 44-52) are not officially reported since same were issued as a Memorandum Findings of Fact and Opinion.

The opinion of the Circuit Court of Appeals (R. 66-77) is not yet reported.

JURISDICTION.

The jurisdictional statement appears in the Petition for the Writ of Certiorari.

STATEMENT OF THE CASE.

Petitioner's statement of the case appears in the Petition for the Writ of Certiorari.

ARGUMENT.

I.

To Tax Petitioner in This Case on the Income of the Trusts Involved Is in Violation of the Constitution of the United States and the Amendments Thereto, Particularly Art. I, Sec. 2, Cl. 3, and Sec. 9, Cl. 4, of the Original Constitution and the Fifth and Sixteenth Amendments to the Constitution.

What the respondent is contending for is the right of the Government, in the guise of an income tax, to levy a privilege tax on the right of a grantor to act as trustee for his issue. It is assumed that if the same powers were vested by the donor in a third party trustee, the donor would not be taxable on the income of such a trust. The respondent has lost sight of the fundamental basis upon which income tax rests and the constitutional and statutory provisions in regard thereto. It therefore behooves us to consider the constitutional and statutory provisions pertaining to income tax so that we may orient ourselves properly.

The Sixteenth Amendment grants Congress the power to lay and collect taxes on income from whatever source derived without apportionment among the several states and without regard to any census or enumeration. This amendment takes income taxes out of the apportionment provision of Article I, Section 2, Clause 3, of the Constitution, which provides that direct taxes shall be apportioned among the several states according to their respective numbers.

This Court in Eisner v. Macomber, 252 U. S. 189, held that income to be taxable under the Sixteenth Amendment must be gain derived by the taxpayer for his separate use, benefit and disposal, and in Helvering v. Stuart, 317 U. S. 154, said on page 168:

> "Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. * * * The 'non-material satisfactions' (gifts—contributions) of a donor are not taxable as income."

From this quotation it is clear that gain realized by a trustee of an irrevocable trust from trust property to be used for the benefit of the beneficiaries of the trust may be taxable to the trustee in his trust capacity or to the beneficiaries who receive the benefit therefrom, but it is not taxable to the donor in his individual capacity unless the donor has reserved to himself as donor such rights and powers in the property as would still leave him the owner thereof.

Keeping in mind the foregoing it is easy to understand the decisions of this Court in **Helvering v. Horst**, 311 U. S. 112, and **Helvering v. Clifford**, 309 U. S. 331.

In the Horst case the owner of negotiable bonds in 1934 and 1935 detached from them negotiable interest coupons shortly before the due date and delivered them as a gift to his son, who, in the same year, collected them at maturity. The Court held that the owner of the bonds was taxable with the interest collected on the coupons which he detached and gave to his son because he who owns or controls the source of the income also controls the disposition of that which he could have received himself or diverted to others as the means of procuring the satisfaction of his wants.

In the Clifford case the taxpayer declared himself trustee of certain securities which he owned. The trust was for a term of five years, except that it would terminate earlier on his death or the death of his wife. On the termination of the trust the entire corpus was to go to taxpayer. During the continuance of the trust he was to pay over to his wife the whole or such part of the net

income as he in his absolute discretion might determine. It was held by the court that as a matter of law it could not conclude that respondent ceased to be the owner of the corpus after the trust was created. There was at best a temporary reallocation of income within an intimate family group.

The logic that runs through both cases is that the taxpayer never parted with ownership of the tree from which the fruit was gathered and, since he owned the tree, the ownership of the fruit which grew thereon would be attributed to him.

In the case at bar the petitioner parted absolutely with all right, title and interest in the corpus of the trust. There was no temporary severance of the fruit from the tree while he remained owner of the tree. There was a permanent and final disposition of the trust property and all rights therein vested in others. No right of reverter was retained. Both in substance and in form there had been a complete disposition of the property by him and all income therefrom. Whatever powers in regard to the property he might exercise thereafter were only exercisable by him as trustee and for the benefit of the trust. Never could he receive the benefit of any income therefrom. The petitioner in fact and in law limited his individual rights when he named himself as the first trustee and acted as such because he could not deal with himself as trustee, whereas, had he named a third party trustee, he could have dealt with such trustee. Whatever power he exercised over the property was appendant to his office of trustee and was controlled by the principles of law applicable to the conduct of trustees. No benefits could be derived by himself personally from any income from or increment to the corpus because no right of reversion was retained in the trust property. All the income was to go to a designated group of individuals and to no one else.

No rights were retained by him as donor except as to the naming of successor trustees. The right to name successor trustees is not the equivalent of ownership. No economic benefit could result therefrom. No one would argue that such a right, if vested in a person other than the donor, would make such person the owner of the property.

It is apparent that to tax petitioner in this case on the income of this trust would be in violation of the Constitution of the United States and the Amendments thereto, particularly Art. I, Sec. 2, Cl. 3, and Sec. 9, Cl. 4, of the original Constitution and the Fifth and Sixteenth Amendments to the Constitution because it would be a denial of due process of law to tax one person upon the gains and profits of another. Such exaction has been condemned by this Court as spoliation, not taxation. Hoeper v. Tax Commission, 284 U. S. 206, and Heiner v. Donan, 285 U. S. 312.

II.

The Decision of the Circuit Court of Appeals for the Eighth Circuit in This Case Is in Direct Conflict With Decisions of the United States Supreme Court.

The decision of the Circuit Court of Appeals in this case conflicts with the decision of this Court in Helvering v. Stuart, 317 U. S. 154, wherein this Court held that broad powers of management in trustees, even though without adverse interests, point to complete divestment of control, as does the impossibility of reversion to the grantors, and further held that economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme and that the non-material satisfactions (gifts—contributions) of the donor are not taxable as income, and wherein this Court held that, disregarding the minority of some of the beneficiaries, the power vested in the trustees, including the grantor-trustee,

to distribute or accumulate income within their discretion would not make the income taxable to the grantor (l. c. 167-168). The language of this Court used in the decision has apt application to the facts of this case and we take the liberty of quoting same:

> "In the John Stuart trusts the trustees, in their discretion, were to distribute income to the named beneficiaries for fifteen years and thereafter to distribute the entire net income. In the Douglas Stuart trusts, the directions authorized discretionary distribution to the beneficiaries or its application to their education, support and maintenance until the children reached the age of twenty-five years. Undistributed portions of the income were to be added to the corpus. Plainly, these distributions or accumulations were to be used for the economic advantage of the children of the settlors and to the amount of these distributions and accumulations would satisfy the normal desire of a parent to make gifts to his children. Is this alone sufficient to make the income of the trusts taxable to the settlors?
>
> "Disregarding for the moment the minority of some of the beneficiaries, we think not. So broad a basis would tax to a father the income of a simple trust with a disinterested trustee for the benefit of his adult child. No act of Congress manifests such an intention. Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. That gain need not be collected by the taxpayer. He may give away the right to receive it, as was done in Helvering v. Horst, 311 U. S. 112, 61 S. Ct. 144, 85 L. Ed. 75, 131, A. L. R. 655; Helvering v. Eubank, 311 U. S. 122, 125, 61 S. Ct. 149, 150, 85 L. Ed. 81, and Harrison v. Schaffner, 312 U. S. 579, 61 S. Ct. 759, 85 L. Ed. 1055. But the donor nevertheless had the 'use (realization) of his economic gain.' 311 U. S., at page 117, 61 S. Ct., at page 147, 85 L. Ed. 75, 131 A. L. R. 655. In none of the cases had the taxpayer really disposed of the res

which produced the income. In Corliss v. Bowers, 281 U. S. 376, 50 S. Ct. 336, 74 L. Ed 916, he had disposed of the res, but with a power to revoke at any moment. This right to realize income by revocation at the settlor's option overcame the technical disposition. The 'nonmaterial satisfaction' (gifts—contributions) of a donor are not taxable as income. Helvering v. Horst, supra."

It also conflicts with the decision of this Court in Reinecke v. Northern Trust Co., 278 U. S. 339, wherein this Court held that the settlor of a trust did not save to himself any control over the economic benefits or the enjoyment of the property which he conveyed to a trust where he reserved to himself (as settlor) the power to supervise the investment of the trust funds, to vote any shares of stock held by the trustee, to control all leases executed by the trustee and to appoint successor trustees.

III.

The Decision of the Court of Appeals for the Eighth Circuit in This Case Is in Direct Conflict With the Decisions of Courts of Appeals of Other Circuits.

The Circuit Court of Appeals for the Seventh Circuit in Katz v. Commissioner, 139 Fed. (2d) 107, in which case the facts were almost identical with those in the case at bar, held that the grantor was not taxable on income of the trust which he had created. In that case he appointed himself sole trustee, conveyed to the trust stock of a corporation of which he was president and of which he owned one-fourth of its outstanding capital stock, vested the trustee with the broadest powers and provided that the trustee should not be liable for any loss incurred by the trust estate and vested the trustee with the right in his discretion at any time and from time to time to withhold and accumulate any of the net income payable to

the beneficiaries or apply any or all of the net income for the benefit of the beneficiaries. The taxpayer was a man of considerable means and had a very large annual income. As trustee he was given full power and authority to manage and control the corpus of the trust estate and also any accumulated income therefrom in such manner as he deemed advisable and as though he were the owner thereof, including the power to invest without regard to the normal restrictions on investment of trust funds and also the right to vote all shares of stock held by the trust. He was authorized to evaluate all distributions and make the same in kind or in cash. He provided that no trustee should be liable for any loss or damage incurred by the trust estate except that caused by wilful default or misconduct. The trust instrument also contained a spendthrift trust provision so that no beneficiary had the right to anticipate or alienate his interest in the trust. The provisions of the trust instrument are set forth in the decision of the Board of Tax Appeals which was affirmed. 46 B. T. A. 187. The opinion of the Circuit Court of Appeals in part is as follows:

> "We agree with the Board that the instant case is distinguishable from the Clifford case. True, there are some elements in common, most noticeable of which are the broad powers of management vested in the trustee. Such matters of similarity, however, are of little consequence and certainly not controlling when considered in connection with other provisions, which, in our judgment, clearly remove the instant situation from the rationale of the Clifford case. The trust in Clifford was of short duration, while in the instant case it is long term in character, having an indefinite and at all times unascertainable duration. Of course, the trust duration is not conclusive, but it is a significant circumstance. Retention by the grantor of economic benefit is more readily attributable in a trust of short term duration. Under the cir-

> cumstances of the Clifford case, conspicuous among which was a short term trust, the Court concluded that there was 'but a temporary reallocation of income.' On the other hand, in the instant case, both the income and corpus, due largely to the long term nature and indefinite existence of the trust, amount to a final disposal which may be characterized as permanent. In Clifford, the trust property was to be returned to the donor in a comparatively short period, while here it will never be returned, except on the contingency of revocation, hereinafter discussed in connection with Sec. 166."

The Circuit Court of Appeals for the Seventh Circuit came to a similar conclusion in the case of Commissioner v. Armour, 125 Fed. (2d) 467. In that case the petitioner created a trust for the benefit of her daughter, who was an adult. The petitioner designated herself as sole trustee. The trustee was charged to pay to her daughter all income and such part of the principal as should be necessary during the daughter's lifetime for the daughter's support, maintenance and comfort. Upon the death of the daughter all the remaining part of the trust estate was to be delivered to the mother, if living, and if not to her estate. The daughter had no right to assign, transfer or encumber the trust estate or its income. The trust instrument provided that the trustee should have as full and unlimited power and discretion as if said trust property were her own absolute estate, not limiting the trustee to such investments as trustees are by law authorized to make, but giving her full power to make and retain any other investments which she might deem advisable. The trustee could purchase and hold as an investment for the trust estate property of any kind, character, nature and description. The court held that the income was not taxable to the grantor under Section 22 (a). It reviewed the Clifford case and the cases which stemmed from it.

The decision in this case is in conflict with two decisions handed down by the Circuit Court of Appeals for the Tenth Circuit, to-wit: Jones v. Norris, 122 Fed. (2d) 6, and Armstrong v. Commissioner, 143 Fed. (2d) 700.

In Jones v. Norris, a much-cited case, the grantor created trusts for the benefit of his children, reserved to himself the right during his lifetime to order the trustee to make settlement in full or in part with any one of the beneficiaries after such one had attained the age of twenty-one years and to order and direct that a certain part of the net income from any one of the trust estates created by him to be paid to the beneficiary. He also reserved to himself full power of control and management over the trust estate and the right to change the trustee. He named his confidential employee as trustee. The court held that under Section 22 (a) as liberally construed by Helvering v. Clifford taxation to the grantor depends upon whether or not the grantor after the trust has been established may still be treated as the owner of the corpus. It then held that the rationale of the Clifford case did not bring the facts before the court within the taxing scope of Section 22 (a).

In Armstrong v. Commissioner, supra, the Court of Appeals was confronted with facts which were very similar to those present in the case at bar and it ruled that the grantor was not taxable on the income of the trust, though he named himself as sole trustee, vested himself with the broadest powers of management and after providing that the net income was to be accumulated during the period of the trust then further provided that he could pay over any portion of the income or corpus to the beneficiaries at any time deemed advisable by the trustee. These powers are set forth more particularly in the opinion of the Tax Court, which was affirmed by the Court of Appeals, 1 T. C. 1008, l. c. 1010-1011.

In Commissioner v. Branch, 114 Fed. (2d) 985, the Circuit Court of Appeals for the First Circuit held, l. c. 987:

> "* * * Where the grantor has stripped himself of all command over the income for an indefinite period, and in all probability, under the terms of the trust instrument, will never regain beneficial ownership of the corpus, there seems to be no statutory basis for treating the income as that of the grantor under Section 22 (a) merely because he has made himself trustee with broad power in that capacity to manage the trust estate."

The decision in this case is also in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in Phipps v. Commissioner, 137 Fed. (2d) 141.

The Court of Appeals in its decision in the case at bar implied that control of the trust stock, together with that which the grantor continued to hold individually, might well have been of supreme importance to his economic welfare.

We wish to remark that the trust instrument nowhere gives the trustee the specific right to vote trust stock. Therefore any right to vote trust stock would flow from the fact that the law vests trustees with the power to vote entrusted shares, if nothing is said in the trust instrument to the contrary. If the rights exists to vote the entrusted shares because nothing is said in the trust instrument in regard thereto, such shares can only be voted in a lawful manner, that is, for the sole benefit of the trust estate. Never can such shares be lawfully voted to the detriment of the trust estate. The power to vote the stock is incidental. It arises from the fact that among the trust assets are shares of stock. The trusts were not created to enable the grantor to vote the shares of stock. That power he possessed before he gave the shares away. His authority to act under the trusts was as trustee, not as grantor. The

trusts were created for the benefit of his children and their issue and not for any benefit that he could personally derive therefrom. Benjamin Lowenstein, 3 T. C. 1133. Secondly, stockholders only elect directors. It is the directors who choose the president, not the stockholders. Consequently it is erroneous to state that the salary received as president can be attributed to the voting of the stock.

Congress when it enacted Sections 161 and 167 of the Internal Revenue Code and provided that grantor-trustees shall not be taxable with the income of the trusts except under the limited circumstances set forth must have had in mind that in these modern times trusts would no doubt have in their portfolios shares of stock and that grantors of such trusts would frequently transfer to the trusts stock of corporations in which they were personally interested as large stockholders, directors or officers, because it is only a natural thing for them to do so. Of course, the fact that the petitioner owned approximately 10% of the common stock and less than one per cent of the preferred stock of the company of which he was president and a director prior to the time he made any gifts of the common stock to the trusts, all of which gifts aggregate less than 25% of the shares owned by him certainly could not make the income of the trusts taxable to him. Ownership of that small portion of the stock could not give him control. Again and of supreme importance is the fact that if his voting of that stock resulted in his receiving some economic gain as an individual, the Government was taxing that economic gain. Thus if it be, for the sake of argument, conceded that the voting of the stock enabled him to become president of the company and receive a salary as such and thereby derive an economic gain as an individual, the Government was collecting a tax thereon from him as an individual because he had to include that salary in his personal income tax return. The trust would account for the economic gain which it derived and, as just stated, he

would personally account for the economic gain derived by him as an individual.

IV.

The Decision of the Circuit Court of Appeals for the Eighth Circuit in This Case Is in Direct Conflict With the Provisions of 26 U. S. C. A., Internal Revenue Code, Sections 161, 162 and 167 (c).

The fact that the grantor acting as trustee may in his discretion either distribute income to the beneficiaries or accumulate same should not be taken into consideration in determining whether or not a grantor is taxable with the income of the trust. This is so because Congress has specifically declared in Section 161 of the Internal Revenue Code that the income which in the discretion of the fiduciary may be either distributed to the beneficiaries or accumulated shall be taxable to the trust except insofar as same may have been distributed and in Section 167 (c) has provided that the income of a trust shall not be considered taxable to the grantor under Section 167 (a) or any other provision of the Internal Revenue Code, including, of course, Section 22 (a), merely because such income, in the discretion of the grantor acting as trustee, may be applied or distributed for the support or maintenance of a beneficiary, except to the extent that such income is so applied or distributed. Consequently we must find the elements which would afford a proper basis for taxing the income of a trust to the grantor in the other provisions of the trust instrument, to-wit, broad powers of management and investment.

In this respect, as we have pointed out heretofore, it has been uniformly held by this Court and the Courts of Appeals of other Circuits that broad powers of management and investment do not make the income of a trust

taxable to the grantor even though he appoints himself trustee.

V.

The Question Involved Is One of Great Public Importance and If the Decision of the Court of Appeals for the Eighth Circuit Is Not Reversed a Great Injustice Will Be Done to Many Taxpayers Who Conveyed Portions of Their Property to Trusts, Retained No Possible Economic Enjoyment of Any Part of the Income or Corpus Thus Conveyed and Are Now Confronted With Taxation on the Income Therefrom, a Result Which Might Bankrupt Some of Them. In Creating These Trusts They Relied Upon the Decisions of This Court and of the Circuit Courts of Appeal of Various Circuits and Also Upon Decisions of the United States Tax Court Which Had Been Reviewed by All Sixteen Members of That Court and in Which the Commissioner Had Acquiesced.

The result obtained by the Commissioner in this case lays the foundation for what might become a vicious practice. The full Tax Court in a line of decisions extending over a period of years has ruled in cases similar to the one at bar that the grantor-trustee is not taxable with the income of a trust created by him where the facts are similar to those in this case.

Ayer v. Commissioner, 45 B. T. A. 146 (acquiesced in by Commissioner, 1942, 1 C. B. 2);

Lowenstein v. Commissioner, 3 T. C. 1133 (acquiesced in by Commissioner, 1944 Ruling No. 1944-18-11847);

Small v. Commissioner, 3 T. C. 1142 (acquiesced in by Commissioner, 1944 Ruling No. 1944-20-11863);

Cherry v. Commissioner, 3 T. C. 1171 (acquiesced in by Commissioner, 1944 Ruling No. 1944-21-11872);

Banfield v. Commissioner, 4 T. C. 29 (acquiesced in by Commissioner, 1944 Ruling No. 1944-23-11896.

These were decisions which were reviewed by all sixteen members of the Tax Court. No appeals were taken by the Commissioner, but, on the contrary, the Commissioner announced his acquiescence in same and therefore they became guides to the public and members of the bar for future action.

In every edition of the Internal Revenue Bulletin of the Treasury Department the Commissioner makes the following statement:

> **"Announcement Relating to Decisions of the Tax Court of the United States, Formerly Known as the United States Board of Tax Appeals.**
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> "In order that taxpayers and the **general public** may be informed whether the Commissioner has acquiesced in a decision of The Tax Court of the United States, formerly known as the United States Board of Tax Appeals, disallowing a deficiency in tax determined by the Commissioner to be due, announcement will be made in the semi-monthly Internal Revenue Bulletin at the earliest practicable date. (No announcements are made in the Bulletin with respect to memorandum opinions of The Tax Court.) Notice that the Commissioner has acquiesced or non-acquiesced in a decision of The Tax Court relates only to the issue or issues decided adversely to the Government. **Decisions so acquiesced in should be relied upon by officers and employees of the Bureau of Internal Revenue as precedents in the disposition of other cases.**" (Emphasis ours.)

In the case at bar, a single member of the Tax Court in his decision departed from the rule announced previously and held contrary to the decisions aforementioned. This

resulted in an appeal on the part of the taxpayer. In the Court of Appeals the Commissioner urged that the Tax Court's determination is binding unless lacking warrant in the record, and the Circuit Court of Appeals held that under the rule of Dobson v. Commissioner, 320 U. S. 489, its function was simply to check whether the appraisal which the Tax Court had made of the elements and incidents of control and of command of income in relation to the terms, circumstances, relationships, object and effect of the particular dedication (creation of the Trust) is wholly arbitrary. As a result you have the decision of a dissident member become the established rule of law contrary to the principles announced by the full Tax Court. In the future the Tax Court will have to follow the decision of the Court of Appeal under our system of legal procedure. The taxpayers are helpless. If the decision is favorable to the taxpayer and against the Government, the Commissioner need do nothing. Therefore, there is no opportunity on the part of the taxpayer to have that decision of the Tax Court approved by the Circuit Court of Appeals and get the benefit of the application of the rule in the Dobson case. The Commissioner can lay back and wait until he has prevailed upon some member of the Tax Court to reach a contrary conclusion (one favorable to the Government), and if the presiding judge of the Tax Court fails to order said decision reviewed by the full Tax Court the taxpayer is then compelled to take an appeal and the Commissioner then resorts to the rule in the Dobson case. As a consequence you have principles become the supreme law of the land which are contrary to the principles announced in well considered opinions of the full Tax Court.

Without a doubt based upon the aforementioned decisions of the full Tax Court and the acquiescence of the Commissioner therein a good number of trusts were created and grantors irrevocably changed their positions in

reliance thereon. They created trusts, made gifts of property to the trusts and were led to believe by these decisions and these acquiescences that they were not taxable with the income therefrom if they came within the purview of these decisions. For the Commissioner several years later to attempt to tax grantors, who acted in reliance upon his acquiescence in the Ayer case and in the other aforementioned cases, on the income of the trusts created by them would not only create intolerable hardships, but would constitute an act of gross injustice. It might lead to the bankruptcy of some grantors for the present rates of taxation on income are so high that to add to the gross income for tax computation purposes income which such grantors do not actually have the benefit of might lead to results where such grantors are compelled to pay more in income taxes to the Government than the total income received by them and it might eat up in the course of a very few years all of their capital. It has ever been the rule of courts that the principles of decisions of courts upon which action has been taken, particularly where administrative departments have acquiesced therein, are rules of property and only under extreme circumstances will the principles of such decisions be disregarded.

As stated in 59 C. J., 1029-1030:

> "The courts are reluctant to overthrow a long-followed executive construction of a statute where to do so would work injustice, unsettle titles, or prejudice persons who have acquired contract or property rights in reliance on such construction and the executive construction will control under such circumstances, unless it is manifestly wrong, or unless some great public measure, benefit, or right is involved, and some authorities have held that such a construction will be followed even though erroneous."

In view of the foregoing rule, it follows a fortiori that, if the executive construction is in itself based upon a judicial construction, much greater weight must be attached to such executive construction and greater hesitancy must be exercised in prejudicing irrevocable action taken in reliance thereon.

Congress enacted the Revenue Act of 1942 after the Ayer case was decided and acquiesced in by the Commissioner, all of which tends to give additional force to the acquiescence of the Commissioner and has the effect of the adoption by Congress of the interpretation of the Act theretofore made, since there was no change in the wording of Section 22 (a) of the previous Revenue Act. This well-settled principle of statutory construction is set forth in 59 C. J. 1030, as follows:

> "Executive construction is entitled to additional weight where it has been impliedly indorsed by the legislature, as by the re-enactment of the statute, or the passage of a similar one, in the same or substantially the same terms, or by failure of the legislature, with knowledge of such construction, to change the law or adopt amendments urged."

Petitioner created the trusts in this case on May 24, 1938. Prior thereto Phoebe Warren McKean Downs had been decided by the Board of Tax Appeals on December 9, 1937, 36 B. T. A. 1129, and had been acquiesced in by the Commissioner, 1938-1 C. B. 9. In that case the grantor had reserved the power to alter the distributive shares of principal and income of the beneficiaries of the classes named in the trust instrument. It was held that the grantor was not taxable with the income of the trust. Furthermore the petitioner relied upon Sections 161 and 167 of the Internal Revenue Code.

The Circuit Court of Appeals in its decision in this case

states that unusually broad powers were granted to the trustee in the trust instruments with which we are concerned. The powers therein contained are in reality the customary powers given to trustees and the Tax Court in many cases which have come before it has recognized same as such. See J. O. Whiteley, 3 T. C. 1265. They appear in standard legal form books which have been published in the last forty years in almost the same language as used in these trust instruments.

In Vol. 2, Scott on Trusts (Austin Wakeman Scott, Dane Professor of law, Harvard University, reporter on Trusts for the American Law Institute), at page 983, Professor Scott says:

> "In the earlier days, particularly in England, trustees were not usually intended to exercise as wide powers of management and control as those which are usually intended to be conferred upon trustees today. There is a general tendency to enlarge the scope of the powers of the trustees * * *."

Further at page 985 he says:

> "Because of the reluctance of many courts to find that the trustee has powers which are not clearly expressed in the trust instrument, and because of the resulting doubts which arise as to the existence of certain powers, it is customary in well drawn trust instruments to make provisions in express words conferring upon the trustee powers which are or may become necessary or appropriate for the efficient administration of the trust. The administration of the trust may be seriously impeded not only by the lack of such powers, but also by doubts, even though the doubts are not well founded, as to the existence of the powers. * * *"

On page 1225 he makes this comment:

> "By the terms of the trust the trustee may be restricted to classes of investments narrower than those in which he would otherwise be permitted to invest. * * *"
>
> "More frequently the terms of the trust instead of restricting the trustee enlarge his powers in making investments."

At page 1238 the author further says:

> "The mere fact, however, that there is a provision in the terms of the trust authorizing the trustee to retain securities in which the testator had invested does not justify him in retaining them if such retention would be imprudent. In such a case the trustee has not only a power but a duty to sell them."

In addition to the broad power of investment and the right to retain at discretion investments of the trust estate, the trustee was vested with the power to determine whether any money or property coming into his hands should be part of the capital or corpus of the trust estate or part of the income therefrom and to apportion between such capital and income any loss or expenditure in connection with such trust estate which in his opinion should be apportioned. Such provision is customarily inserted in modern trust instruments because the receipt of liquidating dividends frequently necessitates an apportionment between principal and income since the dividend received may include both principal and income. In instances where bonds are purchased at a premium it is necessary to apportion the interest received between principal and income in order to amortize the full amount of premium paid prior to the maturity of the bond.

All the powers aforementioned appear in the modern conventional trust instruments, and as a matter of fact many trust companies in the metropolitan centers of this country refuse to accept the trusteeship under trusts unless

they contain such powers which they consider both conventional and necessary. Consequently the Court of Appeals for the Eighth Circuit was in error when it concluded that petitioner wanted to avoid the restraints of a conventional fiduciary-holding of property. That the petitioner vested the trustee with broad powers of management so that the trustee might apply his personal skill and productive capacity, as an income and accumulation factor, in conjunction with the property is not a proper basis for making the income therefrom taxable to him. There is no right to assume that such powers would only serve a purpose in petitioner's hands and not in the hands of the successor. The trusts were created to last during the lives of petitioner's children and therefore in the natural course of events it is to be presumed that such trusts would continue for a considerable length of time after petitioner's death.

The Court of Appeals in this case emphasized the power vested in the trustee to pay over to the primary beneficiary all or such portion of the net income of the trust as the trustee in his uncontrollable discretion should think it advisable or necessary for the comfort, support, education or ease of such beneficiary and to pay over to the primary beneficiary all or such portion of the corpus of the trust as the trustee should deem advisable or necessary for the comfort, support, ease, care or education of the primary beneficiary. These provisions restrict the trustee as to the purposes for which he can make distribution and limit the trustee as to the amounts he can distribute for those purposes.

No matter how broad the discretion be that is vested in the trustee, the trustee is under certain legal restrictions as to the exercise of that discretion and in exercising same must only have the beneficiary's interest at heart. He cannot disregard the purposes of the trust no matter how broad the language of the trust instrument may be

and is personally responsible for any excess or any disregard of the trust purposes. Where a trust instrument provides for distribution or accumulation, he cannot act capriciously, nor can he make arbitrary distributions in utter disregard of the purposes of the trust. He must have the interest of all of the beneficiaries in mind.

2 Scott on Trusts, Sections 187.3, 187.4 and 187.5.

The Circuit Court of Appeals, Second Circuit, in a recent opinion in Helvering v. McCormack, 135 Fed. (2d) 294, pointed out the legal restrictions that rest upon a trustee irrespective of the breadth of the discretion vested in the trustee. The opinion was written by Judge Learned Hand. The trustee in that case was to apply to the use of the child so much of the net income as in the sole and absolute discretion of the trustee might be necessary and proper for the maintenance, education and well-being of the child and the balance of the net income was to be accumulated for the benefit of the child. The instrument provided that the discretion granted should be subject to no other control than that of the judgment of the trustee and neither the child nor any other person on her behalf was to have any power to control the exercise of such trustee's discretion or to compel him to make any other application than that which he might decide upon. The court held that the power to apply the income for the maintenance, education and well-being of the child did not give the trustee power to make gifts. The prospective income was much more than enough for the child's maintenance and the intention was not only to provide for that, but also to accumulate the residue as an investment. Said the Court, l. c. 297:

> "The copious verbiage with which the taxpayer hedged about the exercise of his powers as trustee against any revision by a court, may have extended his power beyond the limit of his paternal duty, but it did not set him free to deplete the accumulations by

any extravagance that whim or caprice might suggest. He had an opposing duty not to defeat the other purpose for which he had created the trust; to accumulate the income so far as it was not necessary for the child's maintenance. And this duty was particularly exacting, since the exercise of the power would relieve himself pro tanto of his duty as parent. Indeed if there had been no limit, he would have set up no trust whatever; the whole transaction would have been mere mummery. A court of equity will not allow such ancillary provisions to strangle the life and purpose of the transaction in chief."

The Court of Appeals for the Eighth Circuit handed down its opinion in the case of Stockstrom vs. Commissioner of Internal Revenue on March 23, 1945 and in the case of Funsten vs. Commissioner of Internal Revenue on April 23, 1945, the day on which it handed down its decision in the case at bar. The same issues were involved in the Stockstrom case as in the case at bar. Similar issues were involved in the Funsten case. A petition for writ of certiorari has been filed in this court in the Stockstrom case and we understand that a similar petition will also be filed in the Funsten case in the very near future. Judge Sanborn, in his concurring opinion in the Stockstrom case, expressed his dismay because courts which are required to determine such controversies as are present in the case at bar must express opinions which are obviously little more than guesses. Witness the following quotation:

"The Tax Court decided that the income of the trust created by Louis Stockstrom was his income for purposes of taxation, under the doctrine of Helvering v. Clifford, 309 U. S. 331, regardless of the fact that he could not recapture either trust income or trust principal. The basis for the decision is that Stockstrom, as donor-trustee, retained such broad powers of control and distribution over trust corpus and income that the income was taxable to him, although he could have none of it for his own use. I think the Tax Court might well have decided this case in favor of the taxpayer, but

the standard for determining to whom the income was taxable is presently so vague and indefinite that I have no conviction as to whether the decision of the Tax Court is, as a mater of law, right or wrong. I therefore concur. I think it is unfortunate that courts which are required to determine such controversies as this must express opinions which are obviously little more than guesses. The number of cases in which the doctrine of Helvering v. Clifford, supra, is invoked indicates the difficulty which the Bench and Bar are having in applying that doctrine. See Shepard's United States Citations on 309 U. S. 331."

This quotation indicates how essential it is that the points of law involved in this case be clarified by this Court. The fact that the Court of Appeals for the Eighth Circuit was called upon to decide three cases involving these points of law within a short time leads to the conclusion that there are many cases throughout the country involving the same questions.

CONCLUSION.

For the reasons hereinbefore stated, it is respectfully submitted that this Court should grant the writ of certiorari prayed for.

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